Consumers Union
Nonprofit Publisher of Consumer Reports

April 14, 2010

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington DC 20551

Re: Regulation Z: Truth in Lending, Federal Reserve Board Docket No. R-1384,

Dear Chairman Bernanke, Members of the Board, and Board Secretary Johnson:

Consumers Union, the nonprofit publisher of *Consumer Reports*,[1] appreciates the opportunity to comment on this proposal to amend Regulation Z and implement certain provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the CARD Act.)

We recommend that the proposed rule be amended to go further in a number of ways to adequately address abusive penalty fees and the drastic rate increases which creditors imposed on their customers during 2009 and the beginning of 2010, prior to the February 22, 2010 CARD Act implementation date.

I. Summary

We ask the Board to implement the following changes to the proposed rule to ensure that penalty fees and charges are reasonable and proportional to the omission or violation.

- The Board should regulate penalty interest rates under its authority to ensure penalty fees and charges are reasonable and proportional.

- The Board should strengthen the safe harbor provision to ensure that it results in a fee or charge that is reasonable and proportional to the omission or violation. The safe harbor should be set at 5% of the violation not to exceed $10.

- The Board should require a bank to demonstrate compliance with the required cost and deterrence analysis, to both the Board and the bank's prudential regulator.

[1] Consumers Union of United States, Inc., publisher of *Consumer Reports*, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. Consumers Union's publications have a combined paid circulation of approximately 7.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and services, fees, and noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

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The Board should strengthen its proposal regarding rate review and reduction. These improvements are necessary to adequately address the abusive rate increases creditors imposed on their customers prior to the February 22, 2010 CARD Act implementation date.

- The Board should require banks to make public the methodologies they use to review rates and should submit to the Board the number of rate increases reviewed and the number of reductions that result from each semi-annual review.

- For rates that were increased between January 1, 2009 and February 22, 2010, for reasons that are no longer permissible under the CARD Act, the Board should require issuers to reinstate the old rates.

- Banks should be required to begin reviewing rate increases on August 22, 2010, not six months after the rules goes into effect, as proposed by the Board.

In addition to these suggested changes, we commend the Board for including a number of strong elements in the proposed rule and include a list in section IV.

II. Comments on Section 226.52 Limitation on fees.

a. Penalty interest rates should be regulated under the provision requiring that penalty rates and charges be reasonable and proportional to the omissions or violations.

Congress authorized the Board to "issue standards for assessing whether the amount of any penalty fee or charge…is reasonable and proportional to the omission or violation..."[2] The Board did not fulfill its duty under this provision when it excluded penalty interest rates from proposed Section 226.52(b). We strongly urge the Board to issue regulations to apply the reasonable and proportional standard to the level of penalty interest rates so consumers are not stuck with exorbitant and permanent penalties that are perpetually applied to their existing balances.

The Board's interpretation of Congress' intent with regard to the penalty fee provision is overly narrow and will be detrimental to consumers.[3] By using the phrase "fee or charge", Congress clearly intended to regulate more than just fee-based penalties such as overlimit and late payment fees. As Senator Dodd stated when the CARD Act was signed into law, "Gone are the days of gouging hardworking families with 'any time, any reason' rate increases and unreasonable fees and penalties."[4] Section 149 was passed to ensure that penalties of all kinds were reasonable and proportional to the violations and not a source of income for the banks. The statute applies the reasonable proportional test to any "fee or charge." The word "charge" must refer to the other common penalty imposed on credit card consumers, a penalty finance charge.

Although under the Act, penalty rates can only be applied to existing balances if a consumer is 60 days late, only new TILA Section 149 can limit the size and length of time consumers will be subject to these astronomical charges if they are unable make the *first* six on-time payments. As of October 2009, research showed that the median penalty rate was 28.99%, or 11-16.75

[2] CARD Act, 111 Pub. L. No. 24, § 102(b), 123 Stat. 1734, 1740 (2009) (to be codified at 15 U.S.C. § 1665d).
[3] *See* Truth in Lending, 75 Fed. Reg. 12333, 12341 (2010) (proposed Mar. 15, 2010).
[4] Press Release, Obama Signs Dodd's Credit Card Act (statement of Sen. Chris Dodd), http://dodd.senate.gov/?q=node/4987 (last visited Apr.9, 2010).

percentage points higher than the median non-penalty rate.[5] Such a drastic increase in the rate applied to an existing balance could place an insurmountable barrier on consumers who are trying to work their way out of debt.

The Board has the opportunity to interpret this provision in favor of consumers and prevent penalty finance charges from being applied to consumer accounts without restraint. We urge the Board to adopt the recommendation from Pew Charitable Trusts to limit penalty rates to a maximum increase of seven-percentage points above the applicable non-penalty rate.[6] Without the Board's adequate regulation, penalty rate increases will keep consumers in a cycle of debt.

b. The Board should strengthen the safe harbor provision to ensure that it results in a fee or charge that is reasonable and proportional to the omission or violation.

Congress authorized the Board to determine a safe harbor fee amount for penalty fees or charges that can be used by issuers without making any determination regarding cost or deterrence, while remaining consistent with the greater purpose of TILA Section 149 to ensure that penalty fees are reasonable and proportional to the violation. The structure of the Board's proposed safe harbor in Section 226.52(b)(3) will not achieve this goal unless the formula is simplified and the "specified dollar amount" is capped at a level much lower than the amounts currently being charged by issuers. We ask the Board to strengthen and simplify the safe harbor provision by eliminating the choice element currently contained in the proposal and by setting the safe harbor to 5% of the violation not to exceed $10. This will ensure the safe harbor does not lead to unreasonable and disproportionate fees.

The choice element contained in the Board's proposal could lead a consumer to be charged a fee that is out of proportion to the violation because it allows the issuer to pick the highest of the two safe harbor formulas. This will greatly disadvantage consumers who make very slight mistakes that cost the issuer little to nothing. For example, if the specified dollar amount in Section 226.52(b)(3)(i) is set at $20, then a consumer who goes overlimit by $20 or pays a $20 minimum payment one day late could be charge $20 for the minor violation. It would be wrong to presume that this result is an accurate reflection of the cost to the issuer or a necessary amount to deter future action. Instead small infractions would become windfalls for issuers. For this reason we ask the Board to eliminate the choice element of the safe harbor altogether.

Instead we urge the Board to adopt Section 226.52(b)(3)(ii) as a stand alone safe harbor equation and set a low specific dollar amount of no more than $10. We agree with the Board that using a percentage to come up with a safe harbor penalty fee is a good place to start because it will correlate with the specific violation rather than set a fixed amount which can be applied regardless of the extent of the mishap. This will protect consumers from being charged high penalty fees for slight mistakes, like the example described above. However a percentage approach must be combined with a low cap.

We urge the Board to adopt a cap of $10 for the penalty fee safe harbor. To charge more than $10 for a violation, regardless of size, a bank should have to demonstrate that the fee is reasonable and proportional using the cost or deterrence analysis.

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[5] NICK BOURKE & ARDIE HOLLIFIELD, PEW CHARITABLE TRUSTS, STILL WAITING: "UNFAIR OR DECEPTIVE" CREDIT CARD PRACTICES CONTINUE AS AMERICANS WAIT FOR NEW REFORMS TO TAKE EFFECT 19 (2009), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit_Cards/Pew_Credit_Cards_Oct09_Final.pdf

[6] *Id.*

c. **Banks should be required to demonstrate their compliance with the required cost and deterrence analysis, to both the Board and the banks' prudential regulator, in a publicly available manner.**

We commend the Board for requiring issuers to demonstrate to their regulator that their cost and deterrence analyses are in compliance with Section 226.52(b)(1).[7] But leaving the task up to regulators that have done nothing to enforce current law will lead to noncompliance. We ask that the Board strengthen this section by requiring issuers to also demonstrate compliance to the Board itself to help ensure that these provisions are sufficiently enforced.

The majority of credit card issuers are regulated by the Office of the Comptroller of the Currency, which attempted to weaken efforts by the Board to protect credit card consumers. The OCC went so far as to openly ask the Board to add significant exemptions to a previous proposed rule to limit the raising of interest rates on existing credit card balances. [8] This does not suggest that the OCC will vigorously enforce the requirements of this rule.

Requiring banks to demonstrate compliance with a regulator that has clearly shown it does not support the regulations it is being asked to enforce will be a worthless endeavor. For this reason the Board should retain some oversight over this process and require issuers to submit compliance reports to both their prudential regulator and the Federal Reserve.

III. <u>Comments on Section 226.59 Reevaluation of rate increases.</u>

a. **Bank rate review methodologies, required by TILA section 148, should be available to the public and banks should submit to the Board the number of rate increases reviewed and the number of reductions that result from each semi-annual review.**

The Board has a duty under new TILA Section 148(d) to issue final rules that evaluate whether banks comply with the rate review requirements contained in TILA Section 148. TILA section 148 requires that issuer's maintain rate review methodologies that are "reasonable," yet the Board specifies no detail in proposed Section 226.59(b) to ensure that issuers comply with this section, beyond requiring that methodologies be written. More detailed requirements are necessary to ensure that issuers comply with Congressional intent and maintain reasonable methodologies for reviewing rate increases.

The existence of a reasonableness standard alone is not enough to ensure that issuers comply with this provision of law. In its explanatory material the Board justifies its minimal proposal by saying, "[t]he Board believes that a requirement that such policies and procedures be reasonable will ensure that the issuers undertake due consideration of these factors in order to determine whether a rate reduction is required on a consumer's account." [9] This does not fulfill the Congressional duty imposed on the Board. We suggest that the Board add two requirements to Section 226.59 (b).

[7] Truth in Lending, 75 Fed. Reg. at 12340.
[8] Letter from John C. Dugan, Comptroller of the Currency, to Jennifer J. Johnson, Secretary, Bd. of Governors of the Fed. Reserve Sys. 3 (Aug. 18, 2008), *available at* http://www.occ.treas.gov/foia/OCC%20Reg%20AA%20Comment%20Letter%20to%20FRB_8%2018%2008.pdf.
[9] Truth in Lending, 75 Fed. Reg. at 12349.

First, the Board should require the written methodologies to be part of the public record. Consumers should have a right to understand the process credit card issuers are using to review rates. As currently proposed, the Board permits issuers to hide their review process in a black box with no agency or public oversight. The proposal requires the review policy to be written but allows that policy to be kept secret from the public. If interested parties are permitted to review the written polices, issuers will be more likely to "undertake due consideration of [the required factors] in order to determine whether a rate reduction is required on a consumer's account."[10]

Secondly, issuers should be required to report to the Board the number of accounts they review and the number that result in a rate reduction, for each semi-annual review they conduct. This would provide a perspective on whether the review methodologies are actually reasonable and whether consumers are gaining the benefits Congress intended by enacting this provision of law. Because the Board is permitting issuers to be flexible in timing their reviews, some issuers may review their accounts on a rolling basis, rather than two specific times each year. To simplify the reporting process, it would be sufficient to require issuers to report on the number of reviews and reductions, once every twelve months, rather than require reporting immediately after each review.

b. For rates that were increased between January 1, 2009 and February 22, 2010, for reasons that would not have been permitted under the CARD Act, require the issuer to reinstate the old rate.

By passing TILA Section 148, it is clear that Congress intended to help the millions of consumers who, between January 1, 2009 and February 22, 2010, had their rates increased for reasons that would not have been permissible under the CARD Act. This provision is their only chance to avoid paying drastic and permanent rate increases on existing balances. To fulfill Congress' intent, the Board must strengthen its proposed rule regarding review of accounts that were subject to rate increases on existing balances before the law went into effect.

Unfortunately, the Board's proposal as it stands will not benefit the intended recipients of TILA Section 148 protections. The Board's proposal is based on an analysis which focused on consumers who will be subject to rate increases on future purchases (permitted under TILA Section 127.) These consumers are already protected from the most damaging and costly affects of rate increases, because, as the Board acknowledges, they have the ability to mitigate the impact by not using their card for new purchases once notified of the increase. [11] They will never be subject to permanent cost increases on debt already incurred and are therefore less dependent on the strength of the required review. The Board did not consider the drastic impact on consumers of rate increases that occurred during 2009 and early 2010, and so it proposed a weak rule that will provide little relief for this segment of the consumer population.

The Board's current proposal is weak in multiple ways. It allows issuers to flip flop between factors, using either market conditions or creditworthiness to justify and maintain rate increases. It delays the start of required rate reviews until February 22, 2011 leaving some consumers without review for up to 26 months. It does not require issuers to reinstate the consumer's old rate when a review leads to an *appropriate* reduction. These loopholes in the proposed rule undermine its benefit for consumers who need review and reduction of unjust rate increases made prior to the February 22, 2010 effective date, as Congress intended.

[10] *Id.*
[11] *Id.*

We therefore ask the Board to require a different, stronger review scheme for accounts that were subject to rate increases between January 1, 2009 and February 22, 2010. For consumers who had their rate increased for a reason that would not have been permitted under new TILA Section 171, the issuer should be required to reinstate their prior rate as applied to their existing balance.

By strengthening the rate review for this important group of consumers, the Board will prevent bad credit card practices from being grandfathered into a system that is now protected by the CARD Act.

c. Banks should be required to begin reviewing rate increases on August 22, 2010, when the rate review provision goes into effect.

By the time the rate review provision goes into effect in August 2010, consumers who have had their rates increased since January 1, 2009, will have already spent anywhere from 9-21 months paying their credit card issuers these increased rates. The Board should not give issuers an additional six months before beginning to review these rate increases. We strongly urge the Board to require the first rate reviews to begin when the provision becomes effective on August 22, 2010.

IV. The Board should remain strong on certain sections of the proposal.

We commend the Board for including a number of strong elements in the proposed rule. These provisions should be retained:

- Section 226.52(b)(1)(i): We support this provision to prohibit rates of loss and their associated costs from the cost analysis.
- Section 226.52(b)(2)(i): We support this provision to prohibit penalty fees that exceed the amount associated with the violation or have no cost associated with them, such as declined transactions, account inactivity, and account closure.
- Section 226.52(b)(2)(ii): We support the Board's decision to prohibit multiple fees for a single transaction and commend the Board for allowing banks to comply with this prohibition by charging no more than one fee per statement period.

We thank you for the opportunity to comment on your proposal and appreciate the Board's efforts on these issues.

Sincerely,

L Bowne

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